FINANCIAL SERVICES ROUNDTABLE

June 3, 2016

Via e-mail

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551
E-mail: regs.comments@federalreserve.gov

Re: Single-Counterparty Credit Limits for Large Banking Organizations; Proposed Rule (RIN 7100-AE 48)

Dear Mr. Frierson:

The Financial Services Roundtable (the "FSR")[1] welcomes the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "Federal Reserve") in connection with the Federal Reserve's re-proposal of the single-counterparty credit limits ("SCCL") for domestic and foreign bank holding companies with total consolidated assets of $50 billion or more (the "Re-Proposal") mandated by Section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] In addition to this letter, the Roundtable is submitting comments jointly with The Clearing House Association L.L.C. ("The Clearing House"), the American Bankers Association (the "ABA"), and the Securities Industry and Financial Markets Association ("SIFMA") on various aspects of the Re-Proposal as they relate to banking organizations that would be "covered companies" under the proposed regulation.[3]

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1 As *advocates for a strong financial future*™, the Roundtable represents the largest integrated financial services companies providing banking, insurance, payment and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. The Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

2 Federal Reserve, Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14328 (Mar. 16, 2016).

3 *See* Letter from The Clearing House, the ABA, The Roundtable and SIFMA, to the Board (June 3, 2016) ("Joint Trades Letter").

While the Re-Proposal would not generally apply to insurance companies subject to, or potentially subject to, designation as systemically important financial institutions ("SIFIs") by the Financial Stability Oversight Council ("FSOC") under section 113 of the Dodd-Frank Act ("Insurance SIFIs"),[4] statements in the preamble to the Re-Proposal indicate that the Federal Reserve intends to apply "similar" SCCL requirements by future rulemaking or order to non-bank financial companies designated by the FSOC.[5] In this letter, we therefore highlight a number of issues that we believe the Federal Reserve should consider in applying an SCCL regime to Insurance SIFIs. FSR representatives or FSR members who could be affected by SCCL rules for insurers would be pleased to meet with the Federal Reserve to discuss these issues before the issuance of an SCCL proposal applicable to Insurance SIFIs. In the discussion below, specialized terms and abbreviations that are not otherwise defined have the meanings specified in the Re-Proposal.

I. Concerns Shared with Banking Organizations That Would be Covered Companies Under the Re-Proposal

As a preliminary matter, we would like to note that application of an SCCL requirement to Insurance SIFIs under the Re-Proposal would raise many of the same concerns as those expressed in the Joint Trades Letter on behalf of banking organizations that would be covered companies, including that:

- the exposures of a covered company and its subsidiaries should be aggregated based on GAAP principles of financial consolidation;

- GAAP financial consolidation should also provide the basis for aggregating exposures among counterparties, rather than the more complex economic interdependence or control relationships tests which require information that may not be readily available and whose relevance to credit exposures is questionable;

- sponsored funds should not be included as part of a covered company and that the definition of "subsidiary" should not be expanded to include any investment fund or vehicle advised or sponsored by a covered company;

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[4] Any nonbank financial institution designated for Federal Reserve supervision, including an Insurance SIFI, would be treated as a "major counterparty" under the Re-Proposal.

[5] Federal Reserve, Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14328, 14329 (Mar. 16, 2016). We are aware that on June 3, 2016, the Federal Reserve intends to issue (1) an advance notice of a proposed rulemaking regarding capital requirements for supervised institutions significantly engaged in insurance activities and (2) a notice of proposed rulemaking to apply enhanced prudential standards to systemically important insurance companies. This letter is in addition to any comments we submit in respect of those notices.

- the Re-Proposal's "look-through" requirement with respect to SPVs and issuers of securities in SPV portfolios would introduce operational complexities with minimal risk reduction benefits;

- the Re-Proposal's proposed application of more stringent credit limits to major covered companies is not justified and that the Re-Proposal should, in any event, exclude certain categories of "major counterparties" (as discussed in Section IV of the Joint Trades Letter); and

- in view of the newness and complexity of the SCCL requirements, the proposed one-year implementation period should be extended.

II. Insurance-Specific Comments

A. The Federal Reserve should exclude from any future SCCL applicable to Insurance SIFIs foreign sovereign exposures that support local and like-denominated liabilities.

Non-U.S. insurance company subsidiaries of U.S. insurance groups hold significant amounts of obligations issued by foreign sovereigns, including their agencies, instrumentalities and political subdivisions, to support insurance liabilities in those jurisdictions. Foreign subsidiaries make investment in these obligations for a number of reasons. For example, foreign insurance regulators typically require insurance subsidiaries operating in their jurisdictions to hold a minimum amount of investments in local obligations. Particularly in jurisdictions where corporate bond markets are relatively underdeveloped, prudent risk management means that these investments most likely would be made in obligations issued by a foreign sovereign, which often may be the most creditworthy counterparty in that jurisdiction.

Similarly, U.S. insurance companies that operate in foreign jurisdictions often issue insurance liabilities denominated in different currencies to support operations in multiple jurisdictions. Investing in foreign sovereign obligations allows insurance companies to better match cash flows associated with these policies, and manage associated interest rate and foreign exchange risks.

In recognition of foreign law requirements and of the need for prudent risk management, the Federal Reserve should exclude from the definition of "credit exposure" (under any future SCCL rule applicable to Insurance SIFIs) any foreign sovereign exposures that support local and like-denominated liabilities. Failure to do so could put covered companies at odds with local law and could interfere with insurance companies' ability to engage in safe and sound asset-liability management.

B. The Federal Reserve should exclude from any future SCCL applicable to Insurance SIFIs short-dated exposures, including cash management exposures, resulting from payment, clearing and settlement activities.

The Re-Proposal would impose a limit of 15 percent of the eligible capital base on exposures of "major covered companies" to "major counterparties" (which would include all of the major clearing and settlement banks)[6] and would also impose more stringent credit exposure aggregation requirements with respect to a counterparty to which a covered company has an exposure of 5 percent or more of its eligible capital base. If applied as proposed to Insurance SIFIs, these limits could potentially impair their cash management operations, particularly those relating to payment, clearing and settlement ("PCS") services.

Most major insurance companies (including Insurance SIFIs) generate significant amounts of operating cash in the ordinary course of business. These insurance companies often rely on large banks, which almost invariably would be considered "major counterparties" under the Re-Proposal, to hold these large balances of operating, clearing and OTC collateral cash deposits. Although the size of these deposits is likely to be large, the amounts are by their very nature temporary, and do not accurately reflect an insurance company's concentration risk to those banks. When taken together with exposures to these same banks resulting from large insurance companies' investment and hedging activities, however, these exposures could exceed the 5 percent limit beyond which a covered company would be required to engage in the burdensome exercise of evaluating and aggregating exposures to "economically interdependent" counterparties, or even the 15 percent absolute cap on exposures to "major counterparties."

Given the size of the cash balances involved, it would be difficult for large insurance companies to diversify these exposures without interrupting their cash management operations, creating inefficiencies and increasing operational risk. As a result, we recommend that the Federal Reserve take into account the practical realities of these large insurers by carving out certain insurance company cash management exposures.

To this end, we note the possibility of an exemption mirroring the European Union's Capital Requirements Directive ("EU CRD"), which provides exemptions for the following PCS-related exposures:

- In the case of foreign exchange transactions, exposures during the two working days following payment;

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[6] *See* Re-Proposal § 252.72, 172.

- In the case of transactions for the purchase or sale of securities exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities (whichever is earlier); and

- In the case of the provision of money transmission services, including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day.[7]

As in the case of the EU CRD, an exemption would appropriately recognize the importance of efficient and effective PCS relationships between insurance companies and banks, and avoid punitive treatment of these relationships under an SCCL framework.

Accordingly, the Roundtable submits that PCS-related exposures should be exempted from any application of the SCCL framework to Insurance SIFIs. This approach would mitigate volatility in SCCL measurement and monitoring and facilitate focus by covered companies on credit concentration issues more directly connected to actual safety-and-soundness concerns.

III. Additional Issues

A. Eligible Capital Base

The Re-Proposal would limit the "net credit exposure" of a covered company to any counterparty to a specified percentage of the covered company's eligible capital base. A covered company's eligible capital base under the Re-Proposal is defined by reference to the covered company's capital stock and surplus, *i.e.* a covered company's tier 1 and tier 2 capital and the balance of the allowance for loan and lease losses not included in the covered company's tier 1 and tier 2 capital under Federal Reserve Regulation Q, or to a covered company's tier 1 capital (for certain large covered companies).

Tier 1 and tier 2 capital are banking terms that do not translate directly to insurance companies; the concept of an SCCL eligible capital base is currently not well-defined or understood for Insurance SIFIs, and as such will require careful consideration by stakeholders in connection with any application of the SCCL to Insurance SIFIs. The Roundtable looks forward to continuing dialogue with the Federal Reserve on this issue.

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[7] O.J. (L 575/2013) 176.

B. Insurance Company Separate Accounts

The Re-Proposal does not specify whether and to what extent assets in insurance company separate accounts will be treated as exposures for purposes of an SCCL for Insurance SIFIs. In other contexts, Federal Reserve regulations distinguish between "guaranteed" and "non-guaranteed" separate accounts, with Regulation Q requiring separate account assets that do not meet the definition of "non-guaranteed separate account" to be risk weighted as if the individual assets were held directly by the bank organization.[8] Although we agree with the proposition that non-guaranteed separate account assets should not be deemed to create exposures for an insurance group, we do not believe it would necessarily be appropriate to import the analytical framework in Regulation Q into an SCCL construct for Insurance SIFIs. Instead, as in the case of the definition of eligible capital base, consideration of whether and to what extent to apply the SCCL to insurance company separate accounts will require careful consideration of the relevant issues.

C. Treatment of Reinsurance Exposures

As in the case of the issues discussed above, the Re-Proposal does not address whether and to what extent an SCCL for Insurance SIFIs would apply to or otherwise affect reinsurance arrangements, a core element of the insurance business. The unique characteristics of reinsurance arrangements, including the use and importance of retrocession arrangements, require an approach distinct from concentration risk management standards designed for banking organizations.

D. Federal Reserve White Paper

The preamble to the Re-Proposal asserts, as a justification for subjecting exposures between "major covered companies" and "major counterparties" to more stringent credit exposure limits, that such entities are "often engaged in common business lines and often have common counterparties and common funding sources. This creates a significant degree of commonality in their economic performance."[9] The Re-Proposal then cites the Federal Reserve staff white paper[10] for the proposition that the correlation

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8 *See* 12 C.F.R. 217.32(m)(1).

9 *See* Federal Reserve, Single-Counterparty Credit Limits for Large Banking Organizations, 81 Fed. Reg. 14328, 14334 (Mar. 16, 2016).

10 Calibrating the Single-Counterparty Credit Limit between Systemically Important Financial Institutions (Mar. 4, 2016), *available at* https://www.federalreserve.gov/aboutthefed/boardmeetings/sccl-paper-20160304.pdf.

in credit default swap spreads between SIFIs between late 2007 and mid-2015 was uniformly above that between a SIFI and a non-SIFI.

However, it seems questionable that bank SIFIs and Insurance SIFIs have sufficiently common business lines, counterparties and funding sources to justify the treatment of Insurance SIFIs as major counterparties of global systemically important banks. We would suggest that the data purporting to justify this approach require additional, careful review.

IV. Conclusion

Thank you for consideration of our comments. The Roundtable and its members welcome and look forward to continuing dialogue with the Federal Reserve on these issues. If it would be helpful to discuss this matter further, please contact me via telephone at (202) 589-2424 or e-mail at Richard.Foster@FSRoundtable.org.

Sincerely Yours,

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